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Insurtech—the threat that inspires

Incumbents need to keep their eyes out for new entrants that use technology to create a strategic advantage. The size of their share in the next generation of the insurance industry is at stake.

New, technology savvy players are entering the insurance sector, bringing the full force of their innovative, disruptive, opportunity-laden power. They will alter the terrain on which incumbents compete, bringing changes not unlike those seen in banking with the emergence of the financial technology companies (“fintechs”).

Fintechs, many of which began as start-ups, have attempted to disrupt the banking sector for over a decade now. They function with much lower cost burden than traditional banks, free as they are of the burden of banking operations, branch networks, and legacy IT systems. By developing innovative products and delivering them digitally in a fraction of the time, they made inroads into business lines traditionally dominated by incumbents.

The fintech story has been changing, however. Forward-looking banks have responded to the challenge, digitizing their operations and offering an array of innovative products and services through digital channels. As revealed in a recent McKinsey study, furthermore, the focus of fintech activity has partly shifted away from directly targeting end customers and competing with incumbents. Traditional banks and fintechs are increasingly becoming partners in ventures in which the incumbents retain ownership of the end customer, while the fintech help to improve the user experience and customer centric approach. Fintechs¹ have indeed changed the face of banking, but traditional financial institutions are catching up, turning what seemed to be a pure threat into a strategy for the leap into the next generation of financial services.

In insurance, a similar pattern is developing. “Insurtechs” are technology-led companies

that enter the insurance sector, taking advantage of new technologies to provide coverage to a more digitally savvy customer base. In some locations, regulatory barriers have been lowered. In Australia, Singapore, and the UK, for example, insurtechs have been encouraged to test their innovative business plans on specific client segments without the need to conform to the full regulatory frameworks that apply to incumbents. Like fintechs, insurtechs are extending innovation throughout the sector, creating a competitive threat to incumbents but also potentially valuable opportunities for partnering on the changing terrain. Customer expectations of instant digital transactions sustained seamlessly across digital channels are increasingly the norm. While insurtechs have not yet made deep inroads into the sector, they are growing fast and stand to capture a meaningful share of value pools within a few years. How quickly incumbents adapt to these inexorable market changes will determine the size of their share in the next generation of the insurance industry.

The rise of insurtechs

Over the past few years, insurtechs have emerged in the insurance space. Investments have grown by leaps and bounds—whereas \$140 million was invested annually in 2011, investment climbed to \$270 million in 2013, and \$2.7 billion in 2015.² Over this same period, the most successful insurtech ventures moved beyond the seed and venture-capital rounds of financing to advanced funding

² The contours of the insurtech landscape presented here are based on CB Insights, a provider of info on VC deals, and the proprietary McKinsey Panorama Insurtech database. This database is a McKinsey solution containing essential information on ~500 insurance technology companies worldwide. Constantly updated by a dedicated team of experts, Panorama Insurtech describes the key elements of insurtech offerings, underlying business models, and targeted customer segments. The database is detail-rich and can be used to zero in on particular success stories, technological trends, parts of the value chain, or insurance products.

¹ Miklos Dietz, Jared Moon, and Miklos Radna, “Fintechs can help incumbents, not just disrupt them,” July 2016, McKinsey.com.

rounds. The average investment per insurtech has risen fivefold, from \$5 million in 2011 to \$22 million in 2015. An analysis from Panorama Insurtech database of the companies' geography of incorporation shows that despite the US has been the pioneering market for insurtech, now only 46 percent of the companies are headquartered in the region with another 40 percent based in EMEA. After the US, the UK and then Germany are the homes of most insurtech companies. Asia-Pacific region accounts for only 14 percent of the insurtechs but is expected to be the fastest growing region in the coming years. Insurtechs are active in all major insurance products and business lines, with concentrations in the P&C business and in the marketing and distribution areas of the value chain (Exhibit 1).

Where insurtechs are now

Not unlike fintechs in banking, the initial focus of the insurtechs has been on the retail segment: 75 percent of insurtech business is in serving retail clientele, with the remainder in the commercial segment. Online and mobile channels and digital technologies offer many quick wins in

retail, as millennials and more youthful age segments take over from the baby boomers. Young, digitally savvy segments are less company-loyal and tend to treat financial products and services, including insurance policies, as interchangeable as long as they fulfill personal needs. They value convenience and like to execute transactions remotely—if possible, without direct interaction with the institution. For the plugged-in cohorts, the use of 24/7 digital channels to receive an insurance quote or submit a claim is infinitely preferable to a branch or office visit.

Although much of the focus of insurtechs is on personal lines, they are also starting to move into the commercial segment. As in personal lines, insurtechs in commercial lines are bringing innovation to products, for instance, peer-to-peer and digital brokerage, often targeting the small- and medium-sized business segment. However, commercial lines insurtechs are also focusing on loss prevention and efficiency (e.g., drone inspection for underwriting and claims).

In terms of lines of business, 46 percent of insurtechs in McKinsey Panorama

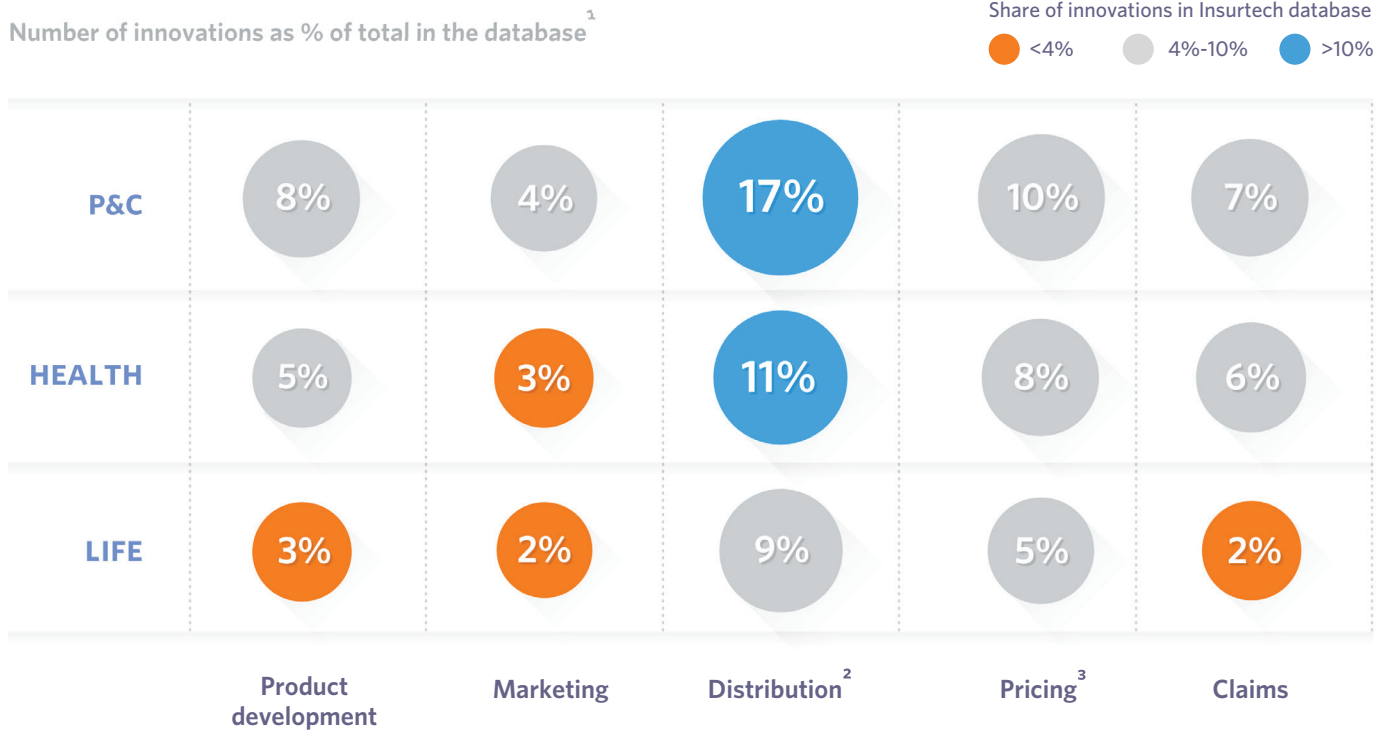
McKinsey's Panorama Insurtech at a glance

McKinsey Insurtech Database includes more than ~500 commercially successful insurtech start-ups. Each start-up's business model is analyzed in detail to understand what is the area of the value chain, line of business, customer segment, etc. where they focus and to get insights on their monetization model.

The database can be a distinctive tool to map and navigate the insurtech universe to find investment or partnership opportunities. It is also useful to shape the vision of the insurance industry, mapping potential future directions of the insurance business to prioritize relevant innovations.

Exhibit 1

Insurtechs have emerged across the value chain and lines of business, with concentration in distribution



¹ -500 commercially most well-known cases registered in the database (excluding wealth management-related innovations); ² Includes sales; ³ Includes underwriting and policy issuance

Source: McKinsey Panorama Insurtech Database

Insurtech database are focused on property and casualty, 33 percent on health, and the remaining on life. Insurtechs target primarily pure risk insurance, where they have developed access points to the value chain based on innovation. Technologies such as telematics and the Internet of Things have enabled new product development in motor, home, and health that drive customer engagement and retention. Insurtechs have attracted consumers with selective discounting based on the intersection of smart devices and risk-minimizing behaviors, offering, for example, meters for car mileage or

calories burned, or in-home flood and fire detectors that autonomously signal emergency services. Along the insurance value chain, insurtechs are active in distribution (37 percent) and pricing (23 percent). Within distribution, 75 percent of insurtechs focus on enabling distribution, by making products available to customers at their convenience, facilitating product comparison, and simplifying the purchasing process. These activities build on the successes of aggregators such as comparethemarket.com or confused.com—e-commerce pioneers that moved into financial services in

the 21st century and are now the leaders in digital insurance.

The insurtech edge is in its early adoption (and adaptation) of new technology. Almost all insurtechs rely on a digital customer interface for sales and service but many insurtechs are also adopting newer technologies and concepts that incumbents are only just beginning to experiment with. Eight important new technologies that have not been widely adopted by incumbents are already being used by insurtechs to solve real business problems. Certain of the new technologies specifically support insurance product innovations, including microinsurance, usage-based insurance, and peer-to-peer insurance; others have applications in many industries and include machine learning, robo-advisory, and the Internet of Things (Exhibit 2). Blockchain is an example of a new technology that is being used by insurtechs (see sidebar “Blockchain in insurance—opportunity or threat?”).

Insurtechs are finding the value pools

Insurtechs clearly represent a market risk for incumbents. With their nimble operating model and digital innovations, they will initially target attractive profit pools unlocked by digital and capture share among certain customer segments. Insurtech start-ups have only begun to address the potential value pools; insurtech is still in its infancy, but already beginning to have an impact on the industry.

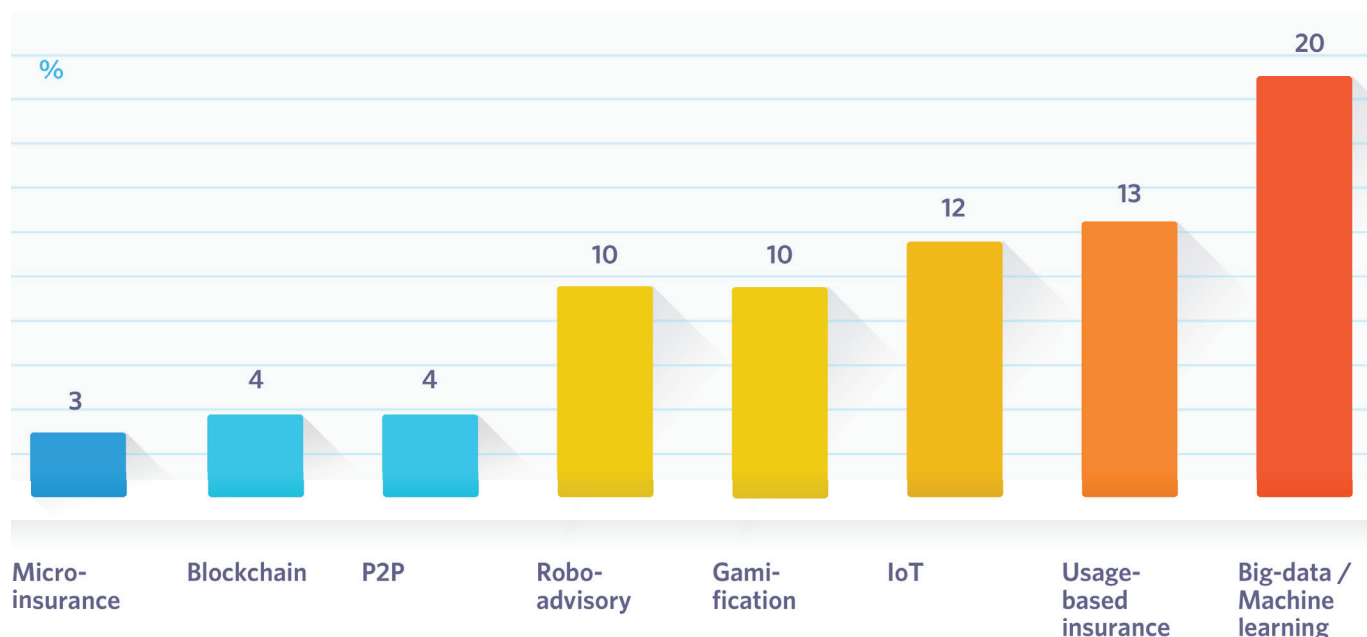
The global insurance industry represents a staggering \$4 trillion premium volume according to the McKinsey Global Insurance Pool. At the same time the industry currently attains relatively modest growth levels in the regions where insurtechs have the highest penetration, i.e. Western Europe and North America. In these regions only the 4-year growth in health significantly outperforms

Blockchain in insurance—opportunity or threat?

Blockchain is a distributed ledger technology with huge innovation potential in all areas of financial services. To date, it is largely in the banking arena where blockchain use cases have been identified. However, the blockchain technology also offers potential use cases for insurers that include innovating insurance products and services for growth, increasing effectiveness in fraud detection and pricing, and reducing administrative cost. In these application areas insurers could address some of the main challenges they are facing today—such as limited growth in mature markets and cost reduction pressures. Implementation of blockchain has a long-term horizon as it depends on network effects as well as on defining the regulatory conditions. Also, before initial implementation steps are taken, the benefits and limitations of the technology need to be fully understood. Considering all of this, now is the best time for the insurance sector as a whole and for individual insurance players to further investigate the blockchain technology and its potential.

Insurtechs are adopting new technology and concepts, especially within big data and machine learning and usage-based insurance

Insurtech adoption of new technology & concepts¹



¹ -500 commercially most well-known cases registered in the database

Source: McKinsey Panorama Insurtech Database

GDP growth with 6.2 percent against 2.7 percent nominal GDP growth while P&C and life only attain 3.0 percent and 2.5 percent growth respectively.

Exhibit 3 shows the primary value proposition per insurtech according to the McKinsey Panorama database highlighting how the insurtechs are attacking the market. Forty percent of insurtechs have a primary value proposition built around finding new ways of growing, i.e. by introducing new products or services or entering new segments, and another 22 percent are focused on lowering acquisition

costs typically by providing customers with a digital interface and using a direct model. The remaining insurtechs have built their value proposition around lowering costs for policy administration, claims management, etc. through digital and leaner processes.

In terms of finding new ways of growing, one key to insurtech success is that they are venturing into untapped markets and addressing unmet needs. BIMA, a mobile microinsurer based in Sweden, provides small-ticket insurance in emerging markets, where mobile penetration is relatively high and insurance coverage

is very low. By providing insurance through mobile subscription in target markets, BIMA has experienced solid growth since its inception in 2011. It now reaches 20 million customers in 15 countries in Africa, Asia, and Latin America, providing pay-as-you-go insurance and mobile health services mainly to people living on less than \$10 a day. Another example of an insurtech finding new ways of growth is Slice that provides coverage for Airbnb rentals meeting a previously unmet, but growing demand for coverage in the sharing economy.

For the insurtechs focused on lowering operating costs their value proposition is built around their digital and lean operating models. For incumbents this value proposition will become even more challenging over time as the insurtechs will continue to enjoy the advantage of being purely digital as they increase the scale of their operations. Direct insurer InShared has shown this in the Netherlands, where they have grown significantly in a saturated market while keeping staff and costs to a minimum.

Exhibit 3

Insurtechs are especially focused on growth and reducing acquisition expenses

Insurtech value drivers¹



¹ -500 commercially most well-known cases registered in the database
Source: McKinsey Panorama Insurtech Database

As the insurtechs make inroads into the insurance industry they might increase the overall growth levels of the industry, and will certainly gain market share with their digital models. Investors and industry talent are believers. Lemonade, a US-based peer-to-peer insurer has attracted significant funding from premier investors, as well as talent from leading insurers, on the promise to “uberize” insurance. The start-up may succeed or it may fail, but its prelaunch reception and its early results are indications of the level of disruption that can be expected.

How insurtechs differ from incumbents

Insurtechs are able to go to market in fundamentally different ways than incumbents can. One advantage insurtechs exploit is their freedom from legacy products, processes, and IT systems. They are able to design digital processes, products, and systems from the ground up, relying on the latest technology. Like the fintechs, insurtechs target particular value pools in the sector, rather than seek to provide end-to-end solutions. Simpler IT and simpler operations translate into less investment and quicker returns. Insurtechs use their digital expertise to maximize value in a number of ways characteristic of truly digital enterprises:

- *Increased connectivity.* Insurtechs such as digital brokers Knip in Germany and Clark in Switzerland are using artificial intelligence and

bots to provide robo-advice through a digital customer interface with digital distribution.

- *Targeted product concepts.* Insurtechs are able to offer personalized small-ticket products based on usage or value-added services. Cuva allows customers to buy hourly car insurance on demand using their mobile phone. Kasko and Simplensurance offer insurance coverage as an add-on purchase within e-commerce websites.
- *Full automation.* By an automated-only approach, insurtechs cut costs and accelerate processes to meet customer expectations. SnapSheet, for example, offers end-to-end automated claims management, while the Claim Di mobile app “shake and go” allows claimants to interact with their carriers on the accident site just by shaking their phone.
- *Data-driven decision making and insights.* With access to diverse sources of data, including telematics from installed boxes and smartphone apps, insurtechs are applying machine-learning techniques to offer innovative, personalized products and services. Metromile, for example, offers pay-per-mile auto insurance to low-mileage drivers in some US states. FitSense allows life and health insurers to use data from wearable technology in underwriting, pricing and claims handling.

Shifting gears: Insurers adjust for connected-car ecosystems

Vehicles are increasingly being outfitted with sensors that gather a massive amount of data that has never been available before. All the participants in the connected-car industry—automakers, insurance companies, insurtechs, sensor and chip manufacturers, and digital-platform giants—stand to be affected by this trend.

For insurers, the challenge will be investing in the technologies and relationships that will allow them to use real-time data streaming from vehicles to offer new products and services to customers, as well as to create long-term growth for the company.

Learn more about connected car ecosystems in “Shifting gears: Insurers adjust for connected-car ecosystems,” on McKinsey.com.

Insurtechs build their business models by addressing the pain points customers experience in their relationships with incumbent insurers. They especially seek to heighten customer interest and foster interaction. They do this in a number of ways:

- ***Social engagement.*** Peer-to-peer insurers, such as Friendsurance, Lemonade, Guevara, and Inspeer, use policyholder pooling to lower rates, but also create a social contract with the policy holder that many traditional insurers would envy. ERSTE Digital, a digital broker offering add-on coverage, sells through social media channels, including YouTube, Instagram, and Facebook.
- ***More frequent interactions.*** On-demand insurers like Trōv are able to offer consumers a mobile-enabled on-off switch for coverage. These innovations promote customer relationships and raise awareness of insurance by making it more relevant.
- ***Digitizing “moments of truth.”*** Customer pain points, whether arising in advice or claims, can make or break customer relationships. Advisory solutions to these “moments of truth,” such as PolicyGenius and HeyBrolly, tackle customer concerns about being over- or underinsured. Likewise in claims, Bauxy allows its customers instantly to initiate straight-through claims processing by taking a photo of an invoice and submitting it electronically.

A few insurtechs at a glance

- **Onsurance** recommends personalized insurance to drivers based on their driving habits. These are tracked with Mojio, a proprietary tool that customers plug into their vehicles which transmits data to the cloud. Onsurance deploys an algorithm on the data collected to find better products in the insurance market and when it does, sends an alert to the customer.
- **Trōv** is an on-demand insurance platform based in Australia and the UK offering coverage for accidental damage, loss, or theft of objects of particular importance to customers, such as laptops, bicycles, or musical instruments. Trōv aims at young people, offering them a highly responsive customer interface with simple and speedy sign-on. A single screen displays all the items prospective customers would like to insure; acquiring or relinquishing coverage is as simple as switching a button on or off.
- **SPIXII** is an insurance “chatbot”—a software application that can interact with humans to carry out specific actions. SPIXII is like an automated insurance agent that guides clients to select policies, receive quotes, and decide on coverage. It operates through a simple user interface much like instant messaging. SPIXII is sophisticated enough to direct questions to clients on the risks they face as well as answer typical questions on insurance products.

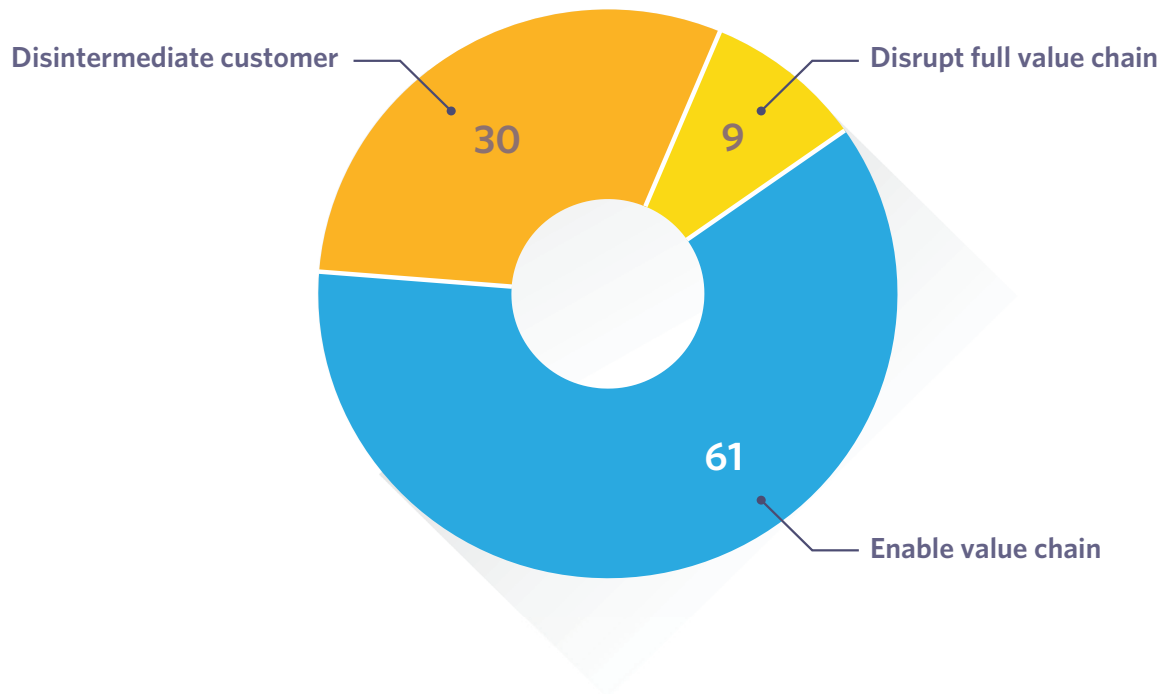
Insurtechs also manifest a next-generation entrepreneurial culture. Founders are often tech-savvy innovators with experience in software or insurance companies. Unencumbered by heavy operations and high investment requirements, they are able to take risks to see what works and what doesn't. They embody the ethos of a digital start-up culture, in which companies appear, fail, and sometimes reappear in modified form, with the lessons of a failure incorporated into a new plan. They tend to adopt a flat organizational style, attracting employees that strongly identify with the company and its mission. With few if any layers separating staff from top management, insurtechs can more easily make adjustments and act on the latest experiences.

The insurtech pathway to improved performance

For incumbents, the news is not all bad—far from it. Insurtechs are not everywhere seeking to displace traditional insurers. The insights generated from McKinsey Panorama Insurtech database suggest that 61 percent of all insurtechs today focus on providing services to insurers, simplifying and digitizing parts of the insurance value chain (see Exhibit 4). Only a small proportion, 9 percent, are aiming to replace the incumbents while 30 percent are focused on disintermediating the customer. Many insurtechs rely on incumbents to underwrite risks. And incumbents are beginning to draw inspiration from

Most insurtechs are focused on enabling the insurance value chain as opposed to disintermediating and disrupting the value chain

Role in insurance valuechain¹



¹ -500 commercially most well-known cases registered in the database
Source: McKinsey Panorama Insurtech Database

insurtechs, studying how they work and using the new technologies and services as they develop their own innovations and digital initiatives. The leading digitizers among insurers—those that have taken pages from the insurtech playbook—are not only more profitable than their less-digital peers but are also growing faster.³

In developing strategies to respond to the insurtech challenge, traditional insurers have the advantage of the lessons of the fintech experience in

banking. That experience helps establish the dimensions of the threat as well as the opportunities it harbors. Insurers can begin to act by focusing attention on three broad topics: the innovation landscape, their own priority areas for action, and possible operating models.

In particular, Insurers' innovation strategy need to be more externally oriented to monitor and analyze continuously the innovation ecosystem that insurtech are building. On the other hand, Insurance incumbents need to assess their business and strategy pain points to have a clear view on which area of the value chain and

³ See Tanguy Catlin, Ido Segev, and Holger Wilms, "The hallmarks of digital leadership in P&C insurance," August 2016, McKinsey.com.

which line of business can be enhanced efficiently with innovation coming from insurtech. Engaging with and being inspired by insurtech could allow incumbents to digitize faster and better and improve their chances in the new digital world.

There are different approaches incumbents can use to cope with insurtech, they can internally develop the technology-enabled business model they get inspired from or acquire the company directly. Many options are in between, from developing a digital lab to founding a corporate venture capital, from collaborating with an insurtech to partnering with a venture capital fund.

However, there is no universal solution, and every strategy depends on the specific context, company ambition and pain point being targeted.

A future article will look into how leading incumbents are collaborating with insurtechs to meet the digital challenge.



The risks insurtechs present to traditional business models are real, as digital innovation relentlessly redefines the

next-generation insurance ecosystem. Incumbents must adapt or lose market share, this much is known. In particular, they will have to address the much higher level of customer engagement that the insurtechs are attaining. Adaptation will bring benefits in many operational areas, leading to cost improvements, better capital allocation, and greater revenue generation. Insurers need to analyze the innovation landscape, compare their in-house technological capabilities with insurtech solutions, and consider their options for moving forward—from digitizing operations to acquiring or partnering with insurtechs. □

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